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2003 UPDATE
OF THE STABILITY PROGRAMME OF GERMANY
(2003-2007)
AN ASSESSMENT

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SUMMARY AND CONCLUSIONS¹

Council Regulation (EC) No. 1466/97, on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies², stipulated that countries participating in the single currency were to submit stability programmes to the Council and the Commission by 1 March 1999. In accordance with Article 5 of this Regulation, the Council had to examine each stability programme based on the assessments prepared by the Commission and the Committee set up by Article 114 (formerly 109c) of the Treaty (from 1 January 1999, the Economic and Financial Committee). The Commission adopted a recommendation on each programme. On the basis of this recommendation and after having consulted the Economic and Financial Committee, the Council delivered an opinion, following its examination of the programme.

Germany's first stability programme covering the period 1998-2002 was submitted on 4 January 1999 and assessed by the Council on 15 March 1999³.

Germany submitted its fifth and most recent update of the stability programme, covering the period 2003-2007, on 5 December 2003. Budgetary negotiations in Germany after that date prompted Germany to submit an addendum to this update on 29 January 2004, incorporating the definitive frames for the Federal Budget 2004. The Commission services have carried out a technical evaluation of this revised updated programme, taking into account the information provided in accordance with the Code of Conduct⁴, the Autumn 2003 forecast as well as subsequent economic developments, the commonly agreed methodology for the estimation of cyclically-adjusted balances, the recommendations in the Broad Economic Policy Guidelines and the principles laid down in the Communication of the Commission to the Council of 27 November 2002 on strengthening the co-ordination of budgetary policies⁵. This evaluation warrants the following assessment.

The fifth update of Germany's stability programme largely complies with the Code of Conduct on the Content and Format of Stability and Convergence Programmes. However, two shortcomings make it difficult to provide a thorough assessment. First, the programme makes frequent use of rounding the data to a quarter and even half of a percent. Furthermore, the Code requires providing a break-down of the budgetary developments by levels of government. While this requirement is respected in the update, transparency of the data provided could have been enhanced, had the assumptions underlying these projections been made more explicit, in particular for the level of the Länder.

¹ This assessment has been carried out on the basis of information available as of 13 February 2004.

² OJ L 209, 2.8.1997. The documents referred to in this text can be found at the following web site http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

³ OJ C 124, 5.5.1999.

⁴ Revised Opinion of the Economic and Financial Committee on the content and format of stability and converge programmes, document EFC/ECFIN/404/01 – REV 1 of 27.6.2001 endorsed by the Ecofin Council on 10.7.2001.

⁵ COM(2002) 668 final, 27.11.2002.

On 21 January 2003, on the basis of a Commission Recommendation, the Council decided in accordance with Article 104 (6) EC that an excessive deficit existed in Germany and issued a recommendation based on Article 104 (7) EC requesting Germany to bring this situation to an end by 2004 at the latest. On 18 November 2003, the Commission adopted two recommendations on the basis of Articles 104 (8) and 104 (9) respectively, for the Council (1) to decide that the measures taken by Germany in response to the recommendation of 21 January 2003 had proved inadequate to bring the excessive deficit to an end, and (2) to give notice to Germany to take the necessary measures to bring the government deficit below 3% of GDP in 2005. On 25 November 2003, the Council did not adopt the two Commission recommendations, but adopted instead a set of conclusions taking note, among other things, of the commitments made by Germany to achieve a reduction of the cyclically-adjusted deficit by 0.6% and at least 0.5% of GDP in 2004 and 2005, respectively, so as to ensure that the general government deficit is brought below 3 % of GDP.

Following the protracted stagnation over the last three years, the 2003 update projects real GDP growth to resume from an estimated minus 0.1% in 2003 to 1.7% in 2004. In the period 2005 to 2007, growth is estimated to average 2¼%. Employment is expected to pick up from zero growth expected in 2004 to an average growth of ¾% from 2005 to 2007. The GDP deflator is forecast at 1% for 2004 and to stay at an average of 1% from 2005 to 2007.

The growth outlook for 2004 appears realistic and is close to the Commission Autumn 2003 projection of 1.6% for 2004. However, the update appears to be rather optimistic regarding the outlook for 2005 and subsequent years, with real growth of 2¼% projected to continue to 2007. The text of the update attributes this to an expected rise in potential output, not explicitly calculated in the programme, the underlying assumption being that the structural reforms – some implemented in 2003 and some forthcoming in 2004 and 2005 – will have an early and substantial positive impact. According to the updated programme, the output gap will not be fully closed by 2007. By contrast, the Commission forecasts real growth of 1.8% in 2005. Moreover, on the basis of the data provided in the addendum to the update, the commonly agreed method results in an estimate for potential growth of 1½% on average between 2005 and 2007. Therefore, even if a cyclical recovery seems to be finally under way, the uncertainties concerning its strength and duration are considerable.

In 2003, despite significant consolidation efforts undertaken by the German government, public finances continued to deteriorate. The general government deficit is estimated in the programme update by the German authorities to have increased from 3.5% of GDP in 2002 to 4.0% in 2003. On 19 February 2004 the German Statistical Office estimated the preliminary 2003 deficit at 3.9% of GDP. Based on the data provided in the programme, the cyclically-adjusted balance improved by 0.2 percentage points in 2003. In its Autumn 2003 forecast the Commission had estimated a deficit ratio of 4.2% and a deterioration in the cyclically-adjusted balance by 0.1 percentage points in 2003.

For 2004, the German authorities project the government deficit at 3 ¼ % of GDP and at 2½% for 2005. At the Ecofin Council of 25 November 2003, Germany committed to reduce the cyclically-adjusted deficit ratio by 0.6 and 0.5 percentage points in 2004 and 2005, respectively. According to the calculations by the German authorities contained in the addendum to the programme update, the budgetary plans for 2004 are consistent with an improvement in the cyclically-adjusted balance by 0.7 and by 0.4 percentage points in 2004 and 2005, respectively. In this way, the envisaged cumulative reduction by 1.1 percentage points would be frontloaded. This effect is due to the political agreement on the budget reached in the mediation committee in Germany in December 2003, which is

accounted for in the addendum to the update. Compared with the plans contained in the December update, parts of the cuts in subsidies (i.a. to commuters, on owner-occupied housing and from the “Koch-Steinbrück package”) have been cancelled. This is partly countered by the introduction of a sustainability fund for the public pension system (from 2005 onwards) and the assumption of offsetting expenditure savings.

However, due to one-time risks in the budget for 2004 the Commission considers likely that the improvement foreseen for 2004 may fall short of 0.7% of GDP. As these risks do not affect the 2005 budget, this shortfall would be reflected as an accordingly greater cyclical adjustment in 2005. In particular, the amnesty on tax evasion may yield less revenue than planned in the government budget for 2004 (while leaving 2005 more or less unchanged). Furthermore, the revenues foreseen from a planned motorway toll system for lorries will not be forthcoming. It is also unclear how the legislated change in the corporate tax regime for health and life insurers will affect tax revenues compared with the official tax estimation of November 2003, on which the 2004 budget is based.

There remains a sizeable risk for the deficit to remain above the 3% of GDP Treaty reference value in 2005 for two reasons. The first is that GDP growth in 2004 and 2005 may well fall short of the central scenario underlying the updated programme. Contrary to previous updates, the sensitivity analysis contained in the new update assumes variations of GDP growth in nominal instead of real terms of ½ percentage point above or below the central scenario for 2004-2007. However, inflation and real growth may impact on the budget in different ways. In the lower (and more realistic) growth scenario the danger for the deficit to exceed 3% of GDP in 2005 is high.

The second risk for the correction of the excessive deficit by 2005 is that the expenditure targets for 2004 or 2005 may not be achieved. In particular, even with growth as expected in the update’s central scenario, unemployment-related, pension and health expenditure may be higher than foreseen.

In the update and its addendum Germany confirms its commitment of 25 November 2003 to correct the excessive deficit by 2005 and, if necessary, to take additional measures to that effect.

According to the update, limiting expenditure remains the cornerstone of the budgetary strategy. The expenditure-to-GDP ratio is projected to fall from 49% of GDP in 2003 by about one percentage point annually until 2007. The bulk of the expenditure restraint is envisaged to fall on social benefits, compensation of government employees and subsidy cuts. Comparing the paths of the expenditure-to-GDP ratio contained in the original programme of 1998 and its updates, it appears that for each consecutive programme, the expenditure target was postponed by one year for most of the years covered. Thus, the actual expenditure-to-GDP ratio in 2003 was 49.0%, only slightly lower than in 1997.

The ratio of revenues to GDP is projected to decline gradually from 45% of GDP in 2003 to 43% in 2007. This is supposed to come from reductions in social security contributions, while the tax ratio is projected to remain constant, the income tax cuts being offset by the effect of the cyclical revival.

The budgetary stance in the update is insufficient to ensure that the Stability and Growth Pact’s medium-term objective of a budgetary position close to balance or in surplus is achieved within the programme period. For 2006 and 2007 the projections, rounded to the nearest half of a percent in the update, are for headline deficits of 2% and 1½% of GDP, respectively. The improvement in the cyclically-adjusted deficit for 2006 and 2007 appears to be rather less than ½ percentage point annually. In addition, a budgetary

position providing a sufficient safety margin to avoid in the future breaching the 3% of GDP deficit threshold under normal macroeconomic conditions would not be reached before 2006.

The updated programme states that the German government revised its fiscal policy targets in 2003 in response to almost three years of persistent stagnation. The budgetary strategy adopted in previous updates had been to limit expenditure, flanked by structural measures to improve the functioning of the labour market, strengthen social security finances and broaden tax bases. While these objectives are confirmed, the aim of stimulating business activity by fiscal policy has been added. Fiscal consolidation over and above the proposed measures is regarded as putting the cyclical upturn at risk. The 2000 update aimed at a balanced budget for the general government by 2004, and the 2002 update postponed the target date to 2006. The 2003 update, while reiterating that achieving a balanced budget is remaining central to budgetary policy, no longer contains a target date.

Given the persistent imbalances in Germany's public finances, this revision of fiscal policy targets carries risks. At the end of December 2003 the third stage of tax relief, planned since 1999 and foreseen for implementation in 2005, was partially carried forward to 2004. Although officially in force since 1 January 2004, companies will need time to adjust their administration to the new tax rules. The hoped-for fiscal stimulus to domestic demand from the tax cuts may thus show up only later this year when the recovery may be already underway. Furthermore, the effect of the tax cuts may not be large. The public is aware that under the present tight budgetary conditions net income gains from tax cuts that result in a higher deficit need to be reversed in the future, as witnessed also by the high private savings ratio in Germany.

Although the updated programme specifies the allocation of the deficit to different government levels and insofar follows the requirements of the Code of Conduct, the presentation is vague about which policies the state and local governments are assumed to be pursuing in order to adhere to this path. This lack of information is regrettable since in 2002 the different levels of government agreed in the "Finanzplanungsrat" on expenditure paths for 2003 and 2004. It is not yet decided whether this agreement will be renewed for the time after 2004. Furthermore, the update is silent about the continuing high fiscal transfers to the eastern part of the country, which remains key for Germany's budgetary prospects.

Speeding up the budgetary adjustment would ensure an earlier and larger decline in the debt to GDP ratio, which has risen from 40% of GDP in 1991 to over 60% of GDP in 1997. It is projected to remain above 60% throughout the period covered by the programme and to start declining slightly only in 2007. The development of the debt ratio still risks being less favourable than projected, given the uncertainty about the medium-term growth rate and the actual achievement of the planned deficit reduction.

On the basis of current policies, the risk of future budgetary imbalances cannot be ruled out. Germany made progress in the reform of the public pension system and to a smaller extent in reforming the health sector. Although such reforms steps are welcomed, the expected effects may not suffice to offset the long-term demographic impact on pension and health care expenditures. According to Commission quantitative indicators on the basis of current policies, the ageing of the population would result in the debt-to-GDP ratio remaining broadly constant over the next 20 years but increasing substantially thereafter.

The economic policies as reflected in the 2003 update are only partly consistent with the

recommendations in the Broad Economic Policy Guidelines, specifically those with budgetary implications. With the “Agenda 2010”, presented in 2003, Germany adopted an ambitious reform agenda for pension and health care systems as well as the labour market, overcoming political constraints. Its implementation over the coming years, should raise the growth potential and, hence, mitigate budgetary problems. However, further reform efforts are required.

Although Germany had implemented in 2003 the consolidation measures which were estimated to amount to 1% of GDP, as requested by the Council, they have proven inadequate to put an end to the excessive deficit situation by 2004. Indeed, there are some risks that the budgetary plans for 2004 and 2005 may not ensure the nominal deficit being below 3% of GDP by 2005. In addition, the new update does not foresee the achievement of a budgetary position close to balance or in surplus up to the horizon of the programme.

1. INTRODUCTION

The 2003 update of the stability programme of Germany was submitted to the Commission on 5 December 2003 and covers the period from 2003 to 2007. On 17 December 2003 the Bundestag and the Bundesrat agreed to the compromise found in the Mediation Committee (Vermittlungsausschuss). This finalised the 2004 budget and clarified the content and scope of imminent structural reforms. Taking this into account, the German authorities submitted an addendum to the programme update on 29 January 2004.

The 2003 updated programme states a modification in the budgetary strategy. The budgetary strategy adopted in previous updates has been to limit expenditure, strengthen social security finances and broaden tax bases, flanked by structural measures to improve the functioning of the labour market. To these objectives the 2003 update adds the aim of stimulating business activity by fiscal policy, because fiscal consolidation over and above the proposed measures is deemed putting the cyclical upturn at risk. The 2000 update aimed at a balanced budget for the general government by 2004, and the 2002 update postponed the target date to 2006. The 2003 update, while reiterating that achieving a balanced budget is remaining central to budgetary policy, no longer contains a target date.

2. MACROECONOMIC ASSESSMENT

2.1 External economic assumptions

The exchange rate assumption of the central macroeconomic scenario in the 2003 update of the stability programme is in line with the Commission's technical assumption in its Autumn 2003 forecast ($\text{€} = \$1.15$). The German authorities, however, expect world trade and oil prices to be less growth supportive than the Commission did in October. More precisely, world trade is assumed to increase by 5½ % in 2004, about 1½ pp less than the Commission forecast, while the oil price is assumed to remain at 28 US Dollar per barrel, which is 7.5 % above the Commission's assumption.

2.2 Domestic macroeconomic developments

In addition to the quantitative assumptions mentioned, the update provides some qualitative information on the underpinnings of the German authorities' short-term outlook. The German authorities expect a gradual recovery of consumer and business confidence in 2004, and monetary conditions to remain conducive to the economic upturn. Apart from the minor differences mentioned above, the recent programme update and the Commission's Autumn 2003 forecast start from a comparable set of assumptions regarding the current year.

Unlike for 2004, checking the medium-term assumptions (2005-2007) for plausibility is more difficult since most statements are purely qualitative. Furthermore, assumptions on oil prices, exchange rates and interest rates remain vague. Judging by the qualitative information in the text, however, the exogenous assumptions underlying the update seem to be broadly in line with those of the latest Commission forecast. Yet it would be desirable if the German authorities provided more quantitative rather than qualitative information on exogenous variables.

As indicated in the second column of Table 1, which compares the 2002 update's macroeconomic forecast for 2003 with the actual outcome, the German economy

performed much worse than was expected. Whereas in the previous update real GDP was projected to increase by 1½ % in 2003, latest figures indicate a mild contraction. As the increase in the GDP deflator was also overestimated, the projection errors added up to an overestimation of nominal GDP growth in 2003 by 2½ pp. Growth projections for 2003 were disappointing across all demand components, particularly regarding private investment and external trade⁶. Notably, the lower than expected world trade growth and the strong appreciation of the Euro constituted a drag on exports. Furthermore, instead of recovering, real private consumption declined further in 2003, presumably due to a larger drop in employment and a smaller increase in gross wage income than previously expected. The largely positive growth contribution of inventories and the negative one of the other domestic demand components also point to a quite unfavourable composition of growth regarding tax revenues.

Table 1:							
Macroeconomic assumptions of stability programmes							
	2003		2004		2005		2006-07
	<i>Prelim. Estimate</i>	<i>SP2002</i>	<i>COM</i>	<i>SP2003</i>	<i>COM</i>	<i>SP2003</i>	<i>SP2003</i>
Real GDP	-0.1	1½	1.6	1.7	1.8	2¼	2¼
Nominal GDP	0.9	3½	3.0	2.5	2.7	3½	3½
Deflator	1.0	1½	1.3	0.8	0.9	1	1
Employment	-1.0	-0	-0.3	-0.1	0.7	¾	¾
Private Consumption	-0.2	1½	1.1	1.2	1.4	2	2
Public Consumption	0.7	1	0.5	-0.2	0.5	½	½
Investment	-3.3	1½	2.8	1.4	2.1	2¾	2¾
Exports	1.1	5½	6.2	5.8	7.5	5½	5½
Imports	2.0	5	5.9	5.0	7.6	5¼	5¼
Growth contribution							
Domestic Demand	-0.6	1	1.3	1.0	1.3	1½	1½
Stocks	0.7	0	0.0	0.2	0.2	¼	¼
External Contribution	-0.2	½	0.4	0.5	0.3	½	½
Annual percentage changes.							
<i>Source:</i> 2003 preliminary estimate released by Federal Statistical Office on 15 January 2004; COM: Commission Autumn 2003 forecast; SP2002/3: 2002/3 update of the stability programme, respectively; Figures for 2004 are taken from the Federal Government's Annual Economic Report 2004; Growth contributions may not add up exactly to total growth due to rounding. The figures for 2005-7 are subject to error, because they are not contained in the programme itself. Instead, they are calculated based on the overall (rounded) averages for 2002-7, which are provided in the 2003 update, and the values for 2002-4.							

Table 1 summarises the main macroeconomic figures of the 2003 update's baseline scenario. As the macroeconomic projections of the programme do not contain explicit annual data for the years 2005 to 2007, the figures for the years 2005-07 in Table 1 were

⁶ Forecast errors were made by many forecasters, including the Commission, but the German authorities had missed the mark by even more.

calculated such that (1) they match the averages for 2002-07 given in the programme and (2) yield consistency between aggregates, on the one hand, and components, on the other. While the update still includes rounded data, German authorities provided Commission staff with precise data. What is more, the Federal Government published on 28 January 2004 for the first time point forecasts of key macroeconomic variables. These figures replace the update's numbers for 2004 in Table 1.

After three years of anaemic growth, the update's macroeconomic projection foresees real GDP growing by 1.7 % in the current year. This figure includes a working day effect of about 0.5 pp. The recovery is expected to follow the typical German growth pattern: As the outlook for of a global recovery brightens, growth will initially be driven by stronger export demand. Firms' improved sales prospects will then lead to higher investment, supported also by favourable financing conditions in terms of relatively low interest rates. Private consumption will eventually pick up, as employment perspectives improve and real disposable income growth accelerates. The German authorities now estimate potential output to grow "at the lower boundary of the 1½-2% margin" in 2004.

The update's projections for the years 2005 to 2007 are based on the German government's medium-term Spring 2003 forecast, adjusted for data revisions and new information that have become available since then. Annual real GDP growth is projected to further accelerate to 2¼ % on average for 2005 to 2007, thereby gradually, albeit not fully, closing the negative output gap. Capacity under-utilisation and moderate wage agreements will continue to dampen price inflation. Domestic demand will be the main engine of growth, although external trade will also contribute. The figures for 2005 to 2007 also reflect the envisaged positive effects of the implementation of the recently adopted reform package.

The update names two main risks on growth: (i) The plans on structural reform are delayed or incompletely implemented; (ii) the twin-deficits in the US affect adversely the sustainability of the US upturn. Yet it also assigns a certain probability to a stronger than expected expansion of the world economy. The German authorities' risk assessment is, however, not quantified in terms of alternative growth scenarios.

2.3 Evaluation by the Commission

The current update's macroeconomic forecast for 2004 broadly resembles the Commission's Autumn projection. Differences are minor, concerning growth of public consumption and private investment, where the Commission figures are above the government's forecast. It is also noteworthy that the update's 2004 forecast for the GDP deflator is below that of the Commission due to a lower assessment of CPI inflation and a lower projected terms-of-trade increase. Latest figures on business and consumer confidence indicators support the view that a gradual recovery of the German economy is already under way.

The update, however, is more optimistic on the outlook for 2005. It assumes real GDP to grow by 2¼ %, compared with the Commission services' forecast of 1.8 %. Specifically, the German authorities are more upbeat about the development of private consumption in 2005. The update's optimistic appraisal is at odds with the expected behaviour of wages and employment, which are, as in the Commission forecast, projected to grow only moderately. In addition, there is no indication that the German authorities expect a decline in the savings ratio mirroring the revival of consumer confidence. The Commission is thus more cautious in its forecast for next year, expecting also only a gradual improvement of the labour market.

The update's outlook for 2006 and 2007 is based on a linear extrapolation of developments in 2005. However, the projected growth composition is questionable, as it implies permanent positive contributions to growth from stocks and external trade. As Germany already in 2003 has a current account surplus amounting of over 3% of GDP, a sizeable increase in that figure over the next four years appears unlikely. Furthermore, real GDP growth rates of about 2¼ % would be well above the average growth rate in Germany over the last ten years. The update fails to explain the factors that lead to these significantly higher rates of GDP growth. Although the implementation of the recently adopted structural reforms can be expected to have positive effects on Germany's GDP growth, the update does not provide information on the quantitative impact nor on the time path.

Regarding the development of potential output, the German authorities acknowledge that the three-year stagnation might have dragged down potential output growth due to lower growth of the capital stock and a slowdown of labour-augmenting technical progress, resulting from longer average duration of unemployment. The update puts potential output growth at roughly 1½ % in 2004 and 2005. However, the Federal Ministry of Finance does not provide a quantitative assessment of the likely positive medium-run effects (i.e. in 2006 and 2007) of the expected economic expansion and of the envisaged structural reforms on potential output. As the German authorities still refrain from publishing detailed estimates of potential output and of the output gap, Commission services inferred the update's underlying path of trend output via applying the commonly agreed method of the Hodrick-Prescott (HP)-Filter on German authorities' real GDP growth forecast.⁷ ⁸ The resulting time path of trend output shows a 1.4 % increase in 2003 followed by a slight acceleration to 1.5 % in 2004 and 2005. The relatively high real GDP growth forecast of 2¼ % on average from 2005 to 2007 then lifts the trend growth rate to 1.6 % and 1.7 % in 2006 and 2007. The implied path for trend output is also consistent with the update's projections of the cyclically adjusted budget deficit, which will be discussed below. Due to lower growth assumptions for the years 2006 and 2007, the Commission services estimate with the HP-Filter potential growth at 1.4 % in both 2004 and 2005 and based on a production function approach at 1.5 % and 1.6 % in 2004 and 2005. Thus, there are no significant differences in the assessment of potential output growth for the period until 2005 between the German authorities and the Commission, but for the time thereafter, which has an impact on the assessment of the medium-term budgetary adjustment, as will be discussed below.

The main risks to the macroeconomic baseline scenario identified in the programme are related to the external dimension. In particular, the large disequilibria in the US economy are seen as a potential downward risk to growth. As the expected rebound of world trade is the key explanatory factor for the projected resurgence of the German economy, a thorough assessment of the potential impact of slower world trade growth and/or a further appreciating Euro would have been desirable. Instead, the update presents a mechanical exercise (sensitivity analysis), evaluating the effects on the budgetary position of a permanent $\pm\frac{1}{2}$ pp shock on *nominal* GDP growth. This might suggest that the German authorities' assessment of risks is balanced. Yet against the background of a

⁷ The "end point bias" problem was solved using ARIMA-model based forecasts of real GDP growth for the years after 2007.

⁸ Until 2005, Germany has a derogation from the production-function method commonly agreed for most of the other member states.

GDP deflator forecast of merely +1.0 % each year from 2004 to 2007 in the baseline scenario, any meaningful interpretation of a negative shock in nominal GDP must imply a parallel decrease in real GDP growth. A positive shock on nominal GDP, on the other hand, could result from an increase in real GDP or an increase in the deflator. Since the Commission assesses the risks to growth as being clearly on the downside, one may therefore regard the pessimistic growth scenario as the more realistic projection. Again, this does not correspond to a fully-fledged macroeconomic scenario, as it only calculates the effects on the budget deficit.

3. BUDGETARY TARGETS AND THE MEDIUM-TERM PATH OF PUBLIC FINANCES

3.1 Programme overview

In the 2003 update, the targeted general government balance has been revised downwards by 1 to 2 percentage points for all years overlapping with the 2002 update. The deviation is particularly strong for 2004 and the following years. The target of a budget close-to-balance will not be achieved in the updated programme's horizon.

Table 2:						
Development of public finances: The 2002 and the 2003 updates compared (% of GDP)						
	2002	2003	2004	2005	2006	2007
<i>Net lending</i>						
December 2002	-3 ¾	-2 ¾	-1 ½	-1	0	-
January 2004	-3.5	-4.0	-3 ¼	-2½	-2	-1½
COM (Autumn 2003)	-3.5	-4.2	-3.9	-3.4		
<i>Primary balance</i>						
December 2002	- ½	½	2	2	3	
January 2004	-0.4	-0.9	- ¼	½	1	1 ½
COM (Autumn 2003)	-0.4	-1.1	-0.7	-0.2		
<i>Consolidated gross debt</i>						
December 2002	61	61½	60½	59½	57½	-
January 2004	60.8	64	65	65½	65 ½	65
COM (Autumn 2003)	60.8	63.8	65.0	65.8		

Source: German stability programmes (various years) and Commission services.

According to the commonly agreed method (in the case of Germany this is still the Hodrick-Prescott filter as a derogation from the production function method) and based on the data provided in the update, the Commission calculates that the implementation of the updated programme would lead to a decreasing gap between the actual balance and the cyclically-adjusted balance towards the end of the update's horizon (Table 3). This reflects the closure of the output gap as discussed in section 2.

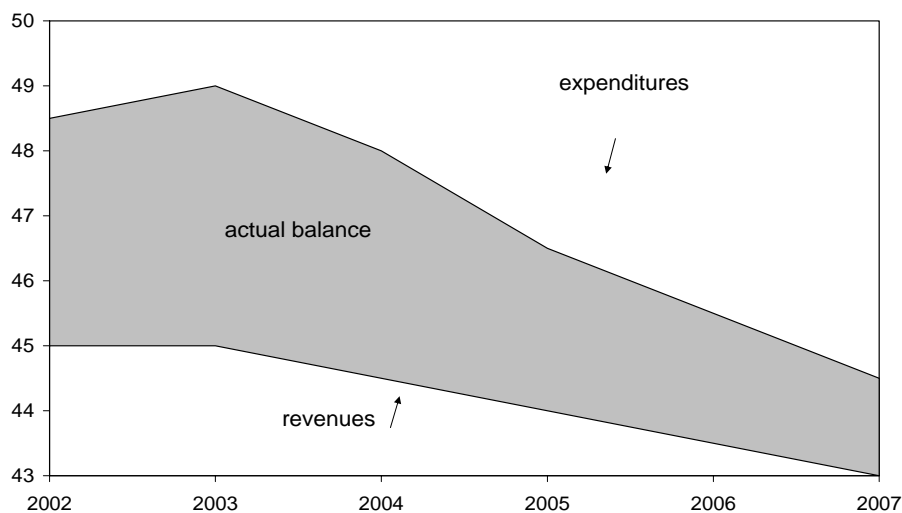
Table 3: Cyclically-adjusted public finances (baseline scenario) (% of GDP)								
	Stability Programme				COM Autumn Forecast			
	Budget	GDP	output gap*	CAB*	Budget	GDP	output gap	CAB
2002	-3.5	0.2	-0.4	-3.3	-3.5	0.2	-0.3	-3.4
2003	-4.0	-0.1	-1.8	-3.2	-4.2	0.0	-1.6	-3.5
2004	-3¼	1.7	-1.6	-2.5	-3.9	1.6	-1.3	-3.3
2005	-2½	2¼	-1.0	-2.1	-3.4	1.8	-0.9	-3.0
2006	-2	2¼	-0.4	-1.6	n.a.	n.a.	n.a.	n.a.
2007	-1½	2¼	0.2	-1.4	n.a.	n.a.	n.a.	n.a.

Note: The first two columns are taken from the update with its customary rounding. The columns marked * are not provided in the programme but are calculated by the Commission on the basis of programme data.

Source: Updated stability programme and Commission services.

The expenditure share in GDP is projected to be declining over time in the update. Most of this reduction is projected to come from reductions in social transfers. The revenue share in GDP is projected to stay roughly constant; however tax revenues will be slightly rising against a fall in social contributions. This may reflect both the update's expectation of favourable cyclical conditions lasting over the medium-term as well as the structural measures outlined in the update.

Figure 1: Composition of the adjustment: actual expenditures and revenues (% of GDP)



Source: Commission calculations based on the data provided in the 2003 update.

3.2 Implementation of previous updates of the stability programme

The German stability programme has been updated five times. In the following, the updates will be briefly compared.⁹ The target of a balanced budget has been postponed repeatedly. The 2000 update foresaw a balanced budget for 2004. In the 2002 update, this target was moved to 2006. The new update remains silent about the ambition of reaching a balanced budget.

Table 4										
Nominal budget balances in updates compared (% of GDP)										
	Programme period									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
SP 1998	-2 ½	-2	-2	-1 ½	-1					
Update 1999		-1.2	-1	-1 ½	-1	-½				
Update 2000			-1	-1 ½	-1	-½	0			
Update 2001				-2 ½	-2	-1	0	0		
Update 2002					-3 ¾	-2 ¾	-1 ½	-1	0	
Update 2003						-4	-3 ¼	-2 ½	-2	-1 ½

Source: German stability programmes (SP, various years).

According to the 2003 update, the cornerstone of the budgetary strategy continues to be limiting public expenditure. Figure 2 displays the projections of the expenditure-to-GDP ratio, where each of the thin lines depicts the expenditure path foreseen in the respective update. The starting point is the forecast for the same year of submission of the update, thus the differences to the actual value is due to small ex post data revisions and rounding. The commitment made by every update was to reduce the expenditure share by about 1% of GDP for each year over the programme period. For each consecutive programme, this expenditure target was postponed by one year for most of the years covered. Between 1998 and 2000, in favourable cyclical conditions, the start of the budgetary consolidation was postponed each year. Since the programme update of 2000, the target for the respective update's horizon has not been revised. Instead, when real GDP growth rates were declining, subsequent programmes seem to have become more ambitious. The respective starting positions were becoming worse and the medium-term growth projections were revised downwards. The actual expenditure ratio (thick line) moved between 49.3 % of GDP (1997), 48.3 % (2001) and 49 % (2003).¹⁰ It follows closely cyclical conditions, which are depicted by the reverse output gap (dashed line, which here rises when actual output falls relative to potential output).

⁹ In all German stability programmes, the projections from the year following the submission of the update onwards are rounded to a quarter or a half of a percent. This practice, intended by the German authorities to take account of forecasting errors, is formally compatible with the Code of Conduct. German authorities have begun to use precise figures in their Annual Economic Report published in January 2004, and it would be welcome if this practice were extended to the programme updates. Although not regulated by this Code, statistical methods superior to rounding could be used to express uncertainty in a transparent manner (e.g. by expanding the short section on sensitivity analysis in the update).

¹⁰ For the year 2000, the proceeds from the UMTS auction (which count as negative expenditure in national accounts) are excluded.

Figure 2: Expenditure as % of GDP projected in the stability programmes and actual expenditure

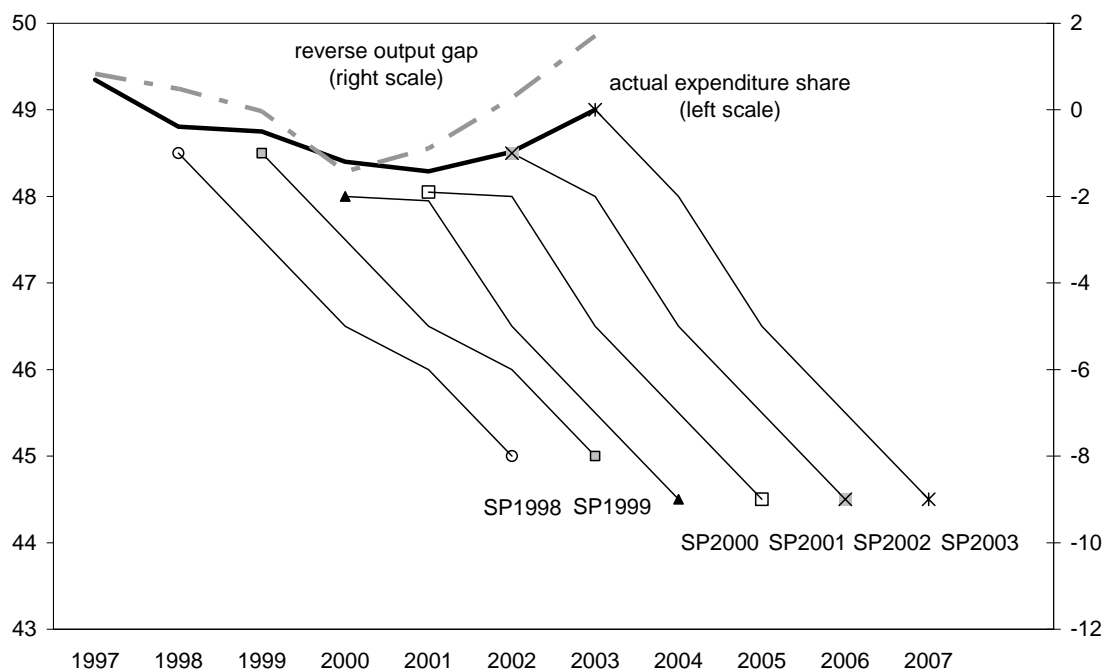
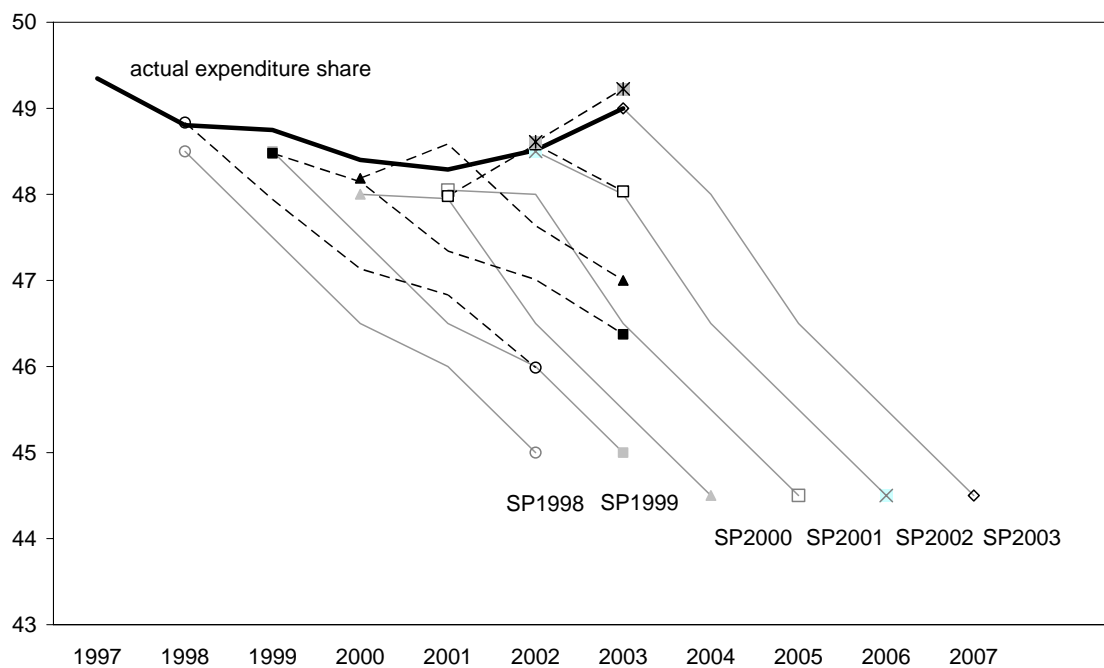


Figure 3: Expenditure shares as foreseen in the updates (grey) and expenditure shares approx. corrected for shortfalls in GDP (dashed)



Note: The stability programmes provide rounded data. The thick line depicts the actual expenditure share. The grey lines are the expenditure share paths as foreseen in the update. The dashed lines are the expenditure paths corrected for the shortfall in GDP (inferred from the nominal growth rates), under the assumption that expenditure levels remained as planned. The programme updates do not contain information on expenditure levels or on planned expenditure growth rates.

Source Fig 2 and 3: Eurostat and stability programmes.

Part of the explanation for revisions is that the protracted downturn has been underestimated (though not only by the German authorities). The medium-term outlook has been revised only slightly downwards. This may express unchanged optimism about sustained favourable cyclical conditions in the medium-term. It may also reflect almost unchanged assumptions about potential output in the medium-term, in contrast to several downward revisions of potential output growth by the Commission services.

The German stability programme presents the planned path of limiting expenditure only by displaying the expenditure share in GDP. According to the standard elasticity used by the Commission, the sensitivity of the expenditure *level* to variations in GDP is very small. Since government expenditure amounts to almost one half of GDP, a one percent fall in GDP increases the expenditure *share* in GDP by almost half a percent, if expenditures are unchanged. The dashed lines in Figure 3 show the paths of the expenditure share corrected for the shortfall in GDP against projections. To do so, the dashed lines assume that the numerator, the expenditure *level* planned when the respective programme was submitted, would have remained the same for a given year in a given programme horizon. This assumption would be consistent with the agreement on expenditures found in the *Finanzplanungsrat* by the federal and the state levels of government.¹¹ There, the targets on expenditure are stated as changes in the *level* of actual (i.e. not the cyclically-adjusted) expenditure. The dashed lines thus take as given the foreseen adjustment path of expenditure levels implied in each programme and correct the projection error in GDP in the expenditure-to-GDP ratio. The planned paths (already displayed in Figure 2) are shown in grey in Figure 3.

Figure 3 allows some tentative conclusions. Clearly, given the lower-than-expected actual GDP levels, the expenditure share is higher than originally projected. In addition, it seems that the paths for the expenditure share paths in the 1998 and 1999 stability programmes were missed because of changes in the expenditure levels. For the updates 2000, 2001 and 2002, it seems that the implicitly planned levels were adhered to at least in the short-term (the year following the submission of the update). In other words, the plans to reduce the expenditure *share* in the short-term seem to have depended much on growth resurgence, less on efforts to reduce expenditure. However, in the medium-term, the expenditure shares corrected for GDP shortfalls (dashed) show a similar slope to the planned expenditure shares (in grey). Thus it seems that in the past the medium-term plans to limit expenditure were not missed because the growth expectations for the medium-term were not fulfilled.

The repeatedly confirmed strategy to reach a balanced budget by limiting expenditure should not only be gauged against the unforeseen prolonged stagnation of activity, but also against the German strategy regarding taxes. Notably the legislation adopted in 1999 and 2000 during the cyclical upturn committed Germany to several steps of tax relief until 2005.¹² It seems that, despite some ambition, a corresponding medium-term

¹¹ The conclusions by the Finanzplanungsrat of 2002 are dealt with in greater detail below.

¹² The 2001 update of the stability programme acknowledged the risks involved: “Germany stands by the objective of achieving a balanced general government budget in the year 2004. This objective is an extremely ambitious one in view of the cyclically-induced tax revenue shortfalls for 2001 and 2002, [...], the tax relief already adopted for 2003 and the base level for 2001/2002. [...] The final year of the projection [2005] is influenced by the further stage in relief provided by the tax reform as already adopted in the summer of 2000.”

commitment on the expenditure side has been missing. In the short-term, however, either the expenditure ambitions were not implemented (in 1998, 1999) or the ambition was rather expecting growth to resurge than a reduction in expenditure levels (in 2000-2002).

3.3 Budgetary developments in 2003

Despite consolidation efforts undertaken by the German government, public finances continued to deteriorate in 2003. In the January addendum to the update, the general government deficit is estimated by the German authorities to have increased from 3.5% of GDP in 2002 to 4.0% in 2003. On 19 February 2004 the German Statistical Office revised the 2003 deficit to 3.9% of GDP. Since this is still preliminary (with the final revision due in August), the analysis presented here is grounded on the data presented in the January addendum to the 2003 update.

The outcome for 2003 falls some 1¼ % of GDP short of budgetary plans of the 2002 update of the stability programme, which projected a deficit of 2¾ % for 2003. An overly optimistic growth assumption, which was already criticised in the Commission assessment at the time, is the most important factor for explaining this shortfall. Weak growth is therefore correctly identified in the update of the Stability Programme as the key element for the budgetary deterioration in 2003. Instead of a projected 1½% rate of growth for 2003 the actual outcome was a negative 0.1%. The budget effect of the growth shortfall was further reinforced by an unfavourable GDP composition, with tax-intensive private consumption falling, while a practically untaxed stock build-up provided a growth contribution of 0.7 % of GDP. In addition, the GDP deflator of 1% in 2003 also turned out to be ½ percentage point lower than expected in the last stability programme update, depressing revenues even further.

An actual growth in tax revenues by 0.3% contrasts starkly with an expected 5½ % rise in the 2002 update of the stability programme. With a drop by 1% compared with 2002, especially value added taxes contributed to the disappointing result on the revenue side, but also income taxes remained well below expectations. Social security contributions were slightly more in line with original expectations but only because the revenue loss due to a contraction in the labour force was counteracted by increases in contribution rates and a broadening of the contribution base. Despite these measures, the government revenue share in GDP remained unchanged compared with a year earlier.

In addition to unfavourable revenues, the increase in unemployment caused a substantial fiscal strain visible not only in deficits in the social security systems, but also in the rising deficit particularly of the central government as a result of unexpected transfers to the Federal Employment Agency.

In 2002 the federal and the state governments agreed in the *Finanzplanungsrat* on expenditure paths for the different levels of government for 2003 and 2004. The federal level was to reduce expenditure by ½% per year on average, and the state and local level combined to limit expenditure growth to 1% annually on average. The latest data (Monthly Report 1/2004, Federal Ministry of Finance) show for the federal level a rise in expenditure by 3% in 2003. For the aggregate state level an increase in expenditure by 0.6% is recorded for 2003 (preliminary data from the financial statistics). Whether the *Finanzplanungsrat* will extend these non-binding guidelines on expenditure beyond 2004, is as yet uncertain.

The Commission Autumn 2003 forecast projected a deficit of 4.2% of GDP for 2003 and, on this basis, an increase in the cyclically-adjusted deficit by 0.1 percentage point from 2002. Yet, according to Commission calculations based on the more recent data provided

in the programme,¹³ the cyclically-adjusted balance improved by 0.2 percentage points in 2003 compared with the year before. This falls short of the target of the last update, which envisaged an improvement by 1 percentage point, as well as the commitment by the German government to take deficit reduction measures in 2003 in the order of 1 % of GDP in the context the excessive deficit procedure (see Box A). However, the small improvement of the cyclically adjusted balance appears to be due not so much to Germany's failure to implement its budgetary plans, but rather to the fact that the decomposition of the actual deficit into a cyclical and a structural component does not capture a number of exceptional circumstances. Relevant factors are a revision of budgetary data for 2002, the budgetary impact of the measures taken being lower than anticipated, and a higher trend deficit due to the fact that growth turned out lower than expected in the Stability Programme on which expenditure plans were based (see Box B). However, in 2003 the starting point has deteriorated substantially compared with original plans, hence preventing to correct the excessive deficit by 2004, as recommended by the Council on 21 January 2003.

¹³ The federal statistical office Destatis released preliminary figures for 2003 on 15 January 2004, which were included in the addendum to the update.

BOX A: THE EXCESSIVE DEFICIT PROCEDURE IN GERMANY***Triggering of the EDP***

The Commission initiated the Excessive Deficit Procedure for Germany on 19 November 2002, with the adoption of the report foreseen in Article 104(3) of the Treaty. This decision was based on the Commission's Autumn economic forecast released on 13 November 2002, which projected for Germany a general government deficit of 3.8% of GDP for 2002, indicating a clear excess of the reference value of 3% of GDP. The updated Stability Programme of Germany, received by the Commission on 18 December 2002, confirmed a government deficit figure of 3 ¾ % of GDP for 2002. In its notification of 29 August 2003, the German authorities revised the deficit figure for 2002 down to 3.5% of GDP.

Recommendation according Article 104(7)

According to Article 104(7) of the Treaty, the Council recommended to Germany on 21 January 2003, to put an end to the excessive deficit situation as rapidly as possible in accordance with Article 3(4) of Council Regulation (EC) No 1467/97. This implied that the excessive deficit situation should be ended by 2004. In addition, the Council requested to carry out budget consolidation measures amounting to 1% of GDP in 2003. As a consequence, the German government implemented measures in the order of over €20 billion.

Recommendation of the Commission according to Article 104(9)

On the basis of a projected deficit of 4.2% of GDP in 2003 and the confirmation by German authorities that the 2004 deficit will exceed 3% of GDP, the Commission adopted on 18 November a Recommendation for the Council to decide that action taken by Germany was inadequate to bring the excessive deficit to an end, in accordance with Article 104(8) of the Treaty. At the same time, the Commission adopted a recommendation to the Council to take a decision pursuant Article 104(9). In light of the weak economy, the Commission recommended to the Council to allow Germany an additional year (i.e. until 2005) to bring the general government deficit below 3% of GDP and to require Germany to reduce the cyclically-adjusted deficit by a total of 1.3% of GDP, of which 0.8% in 2004.

Decision adopted by the Council on 25 November

On 25 November 2003, the Council adopted a conclusion putting the excessive deficit procedure for Germany in abeyance. The Council took note of the commitments made by Germany to achieve a reduction in the cyclically-adjusted deficit by 0.6 percent of GDP in 2004 and by 0.5 percent of GDP or a larger amount in 2005 so as to ensure that the general government deficit is brought below 3 percent of GDP in 2005. This is less than the consolidation effort recommended by the Commission.

BOX B: DEVELOPMENT IN THE GERMAN NOMINAL AND CYCLICALLY ADJUSTED DEFICIT

The preliminary data released in January meanwhile indicate a 2003 government deficit for Germany of 4.0% of GDP. This figure implies an improvement of the cyclically-adjusted balance (CAB) of 0.2% of GDP compared with the 2002 deficit. While this is well short of the 1 % improvement that, everything equal, could have been expected as a result of compliance with the Council EDP recommendation of 21 January 2003 (see Box A), such simple abstraction is not sufficient to conclude that Germany did not comply with the Council recommendation.

An analysis of the budgetary developments in Germany in 2003 comes to the conclusion that Germany broadly implemented a budgetary package of the required magnitude. Without it, the 2003 deficit would have been well above 4 ½ % of GDP. Also, there is no indication of significant budget slippage compared with plans, apart from expenditures related to the labour market.

The shortfall in the cyclically-adjusted balance can be explained by three main factors.

- Roughly one quarter of the gap is due to technical factors. Notably, the 2002 deficit figures were corrected downward by 0.1 percentage point of GDP as a result of factors that do not reduce the 2003 deficit in parallel. Furthermore, the consolidation package included the postponement of the 2003 tax cut. Its implementation would have led to a worsening cyclically adjusted balance in 2003; its postponement leaves the CAB unchanged.
- Another quarter of the shortfall is due to an overestimation of the effectiveness of the consolidation package. This aspect can be estimated only roughly because the budgetary impact of the discretionary measures cannot be easily filtered out of other developments that influence revenues and expenditures
- Most of the shortfall comes from a German trend deficit (i.e. the budget development without the consolidation measures) that was substantially worse than previously thought. This comes about because budget plans were based on a too optimistic growth assumption. As growth—both actual and potential—was revised downwards substantially and expenditure plans were kept unchanged, the expenditure to potential GDP ratio increased, leading to a deterioration of the CAB by one-half percentage point.

3.4 Adjustment in 2004

The stability programme update projects the general government deficit of 3¼ % at GDP in 2004, down from 4 % in 2003. The values presented in the addendum to the update are ¼ of a percentage point lower than those presented in the original December update. This reflects the fact that the compromise of the mediation committee reduced the originally foreseen tax cut by an amount of some €7 billion, leading to a relatively lower deficit than originally foreseen¹⁴. At the same time, the committee did not adopt in full the proposed spending restraint, notably the planned reduction in commuter and housing subsidies. In 2004, the effect of this change compared with original government plans is, however, relatively small.

Despite the still sizable reduction in the income tax burden, the budgetary plans foresee a sizeable net consolidation effect. The bulk of the budget consolidation is due to the fact that the tax reduction is counteracted by a large number of measures linked to the so-called Agenda 2010 and the Hartz labour market reforms, which lead to expenditure reductions in the social security system, notably by lowering unemployment benefits and health care costs, and a freeze in the level of pensions. In addition, the budget foresees global expenditure cuts, an increase in tobacco taxes, motorway tolls for lorries, and large one-time revenues as a result of a tax amnesty.

The economy wide tax share in 2004 will remain unchanged compared with 2003 at 22½ % of GDP, because the significant drop in income tax rates is counteracted by an increase in tobacco taxes and a tax amnesty. In addition, corporate taxes, which have fallen to very small amounts since the 2001 tax reform will gradually rise again, not least by introducing a cap on the amount of loss write-offs in a given year. The government also intends to broaden the tax base by a reduction in the relative size of the black market economy. At least in the area of mini-jobs there are signs that this strategy might be successful to some extent.

The most visible impact of the 2004 budget changes is in the social security system. The predicted pick-up in economic activity, the health care reform, the pensions freeze, and the reform of the unemployment insurance are expected to lead to a significant retrenchment of government expenditures in this area by more than one percentage point of GDP. These cost savings do not translate fully into a net budgetary consolidation, because they are accompanied by a reduction in social security contributions. The government particularly reckons that the health insurance sector will reduce its contribution rates. Overall, the programme therefore expects the government expenditure share to fall from 49% of GDP in 2003 to about 48% in 2004, while the revenue share is expected to fall more slowly from 45 % to some 44 ½ % of GDP in the same time.

The core elements of the budgetary plans for 2004 can be considered realistic. The macro-economic scenario is close to that of the Commission forecast of Autumn 2003 and broadly consistent with the latest economic data. The underlying assumptions for tax revenues are therefore likely to be robust.

However, there are at least three items that pose considerable negative risks to the overall budget plans. The first one concerns the estimated impact of the amnesty on tax evasion,

¹⁴ While the original plans were based on an overall tax reduction in income taxes in the order of over €22 billion, the agreed reduction after the mediation committee stands at €15 billion.

which has been budgeted to result in one-time revenues in the order of €5 billion. Some tax experts have questioned that the tax amnesty would have any positive revenue impact at all. The optimism of the government concerning that item alone constitutes a risk to the deficit target equivalent to 0.2 % of GDP.

The second problem is the unresolved issue of the road toll, whose introduction is delayed significantly due to technical difficulties on the part of the contractors, leading to a budgetary risk of up to €2 billion, depending on when and in what form a system will finally be put into place. In December 2003, the corporate tax regime for health and life insurers was changed. In the present situation, this will allow them to offset to a large extent the losses from asset sales, also retroactively, against their tax bill. It is unclear how this regime change will affect tax revenues compared with the official tax estimate of November 2003, on which the 2004 budget is based.

Finally, there is the continuing structural risk that the budgets of the Länder will not remain within their planned limits. Länder and local governments, which together control a budget that is about 1½ times as big as the federal budget, are to provide about one-half of the total consolidation volume of the roughly €14 billion between 2003 and 2004. In the aforementioned *Finanzplanungsrat* agreement running until the end of 2004, the Länder committed to limit the rise in their expenditure at a nominal 1% annually. The most visible signs of this commitment is that the Länder are vigorously cutting personnel expenditure through the reduction of Christmas and holiday bonuses. Some Länder have done so already in 2003, so that for 2004 at the aggregate state level the leeway to cut expenditure on employees is somewhat limited. However, there exists no sanctioning mechanism, e.g. in the form of an internal stability pact, that would make the overall expenditure goal a binding target.

According to the calculations by the German government, the overall budget in 2004 will lead to a cyclically-adjusted improvement in the order of 0.7% of GDP compared with 2003. However, if the budget risks for 2004 materialise, the nominal budget deficit ratio for 2004 is more likely to be one- or two-tenths of a percentage point higher than what is foreseen in the addendum to the Stability Programme. Consequently, the structural improvement in 2004 would be more in the order of 0.5 to 0.6% of GDP in the current year, which is still in line, but certainly not above the commitment made by the German government to the Ecofin Council of 25 November 2003.

3.5 Developments in 2005 and beyond

In the central scenario of the 2003 update, the German government projects the general government balance to improve by ¾ % of GDP in 2005 and by a further ½ % in each of the following years. The general government deficit is therefore projected to be reduced to a rounded 2½ % of GDP in 2005, to 2 % in 2006 and to 1½ % in 2007.

The compromise reached in the Mediation Committee made the attainment of budgetary targets for 2005 more difficult than the original budget proposals that were the basis of the December update of the stability programme. Notably, government plans for fiscal consolidation, such as the reduction of housing and commuter subsidies, were partly taken out of the original budget. Only for 2004, this is compensated by postponing final tax reduction step. This provides however, no consolidation in 2005.

Nevertheless, the January addendum to the update only presents a very small upward revision compared with the figures of the December update as a result of two facts. First, the addendum includes the creation of a “sustainability reserve” for the pension insurance (to be built up at a rate of ½ % of GDP by 2007), which was not included

previously. Second, the tighter budget situation will put a number of Länder closer to their constitutionally allowed deficit limits, according to which deficits must not be larger than the level of investments. The amended update therefore assumes that the revenue losses are at least partly compensated by a tighter budgetary execution.

Even so, there are considerable risks to the budget target of 2005. While for 2004, the risks were mostly related to the assessment of individual budget items, in 2005 the most important factor is the optimistic growth assumption. As discussed in Chapter 2, the growth forecast of 2¼ % annually for this and the following years is well above the calculated potential growth of some 1½ %. A growth assumption for 2005 in line with the 1.8% of the 2003 Commission Autumn forecast and, applying the standard budget elasticities, would move the deficit up to some 2.8 % of GDP, thereby leaving a much smaller the margin from the 3% deficit threshold.

In the programme, the improvement of the CAB in 2005 is only 0.4% of GDP as compared with the German commitment of 0.5%. However, if the Commission is right in its scepticism of the fiscal effect of the tax amnesty – which is a one-time effect - the CAB improvement in 2004 will be smaller, while the improvement for 2005 will be automatically higher than foreseen in the programme. A more critical issue for achieving the deficit target for 2005 is that the improvement in 2004 and 2005 combined is barely above 1% of GDP in structural terms. For a country in excessive deficit, this falls short of being an ambitious deficit reduction programme.

Importantly, however, in the update and its addendum, Germany confirms its commitment of 25 November 2003 to correct the excessive deficit by 2005 and, if necessary, to take additional measures to that effect.

In the final two years of the programme period, this ambition is no greater. According to Commission calculations, the CAB improvement for 2006 and 2007 falls even mildly short of ½ percentage point annually. Furthermore, the projected nominal deficit reduction towards the end of the programme horizon relies on buoyant growth of 2¼ % annually, at least ½ percentage points above potential output rates. Such growth rates are only possible if medium-term output gap closure is combined with the projected increase in potential output as a result of government reforms, which like the Agenda 2010 and Hartz reforms have started to ease growth constraints. Nevertheless, the growth expectations are rather on the optimistic side.

Moreover, the Stability Programme no longer makes any mention of a target date for achieving a budget close to balance, which the last update still foresaw for 2006. Indeed, both the actual and cyclically adjusted deficit targets for 2007 remain above 1% of GDP.

As in 2004, the update projects the bulk of the adjustment burden from 2005 onwards to be relatively evenly distributed between the federal budget on the one side and local and Länder budgets on the other, even though the changes imposed by the Mediation Committee compared with original plans place relatively more burden on the federal budget than on the lower government levels. Importantly, the social security systems are expected to move into surplus from 2005 onwards, notably because the pension system is foreseen to build up the aforementioned sustainability reserve.

The budget consolidation strategy of the stability programme implies a substantial reduction in relative government size in the medium term. The revenue share is to decrease by two percentage points from 45% of GDP in 2003 to 43 % in 2007. Tax ratios will remain practically unchanged, but social security contributions and other revenues are planned to be reduced. Consolidation relies on the expenditure share falling at a much

faster pace from 49% of GDP to 44½ % over the 2003-2007 period. Decisive element is a reduction in the costs of the welfare state. It remains unclear, however, how the containment of expenditure is to be achieved. Earlier in this section, it has been pointed out that for several years in a row there has been a clear gap between the consistently ambitious expenditure reduction goals of past stability programmes and their final implementation.

Lastly, the Commission estimates that a minimal benchmark for a budgetary position providing a sufficient safety margin to avoid breaching the 3% of GDP deficit threshold under normal macro-economic conditions would be a cyclically-adjusted deficit of 1.6% of GDP.¹⁵ According to update, such a benchmark would only barely be reached by 2006.

3.6 Sensitivity analysis

As discussed in section 2, no full-scale sensitivity scenario is provided in the stability programme, apart from an variation in the nominal growth between 2004 and 2007 by ±½ pp annually. The rather scant information on these scenarios does not provide a sufficient basis for an in-depth analysis. Based on Germany’s economic performance of the last ten years, however, the lower growth scenario appears to be the more realistic one. It is important to note that under this scenario, the nominal deficit for 2005 stands at a rounded 3% of GDP in the programme. Clearly, therefore the achievement of the deficit goal remains subject to a considerable risk, leaving little to no room for any unexpected slippage. This is particularly true insofar as the underlying data already assume the various levels of government to exploit their potential for expenditure savings to the full. If the expenditure plans made for 2005 are based on a too optimistic GDP projection, there will be little scope for the various levels of government to squeeze their deficits further in the short run.

Table 5:						
The three deficit scenarios						
(% of GDP)						
<i>Net lending</i>	2002	2003	2004	2005	2006	2007
Scenario November 2003 (baseline)	-3.5	-4	-3½	-2½	-2	-1½
Scenario November 2003						
• <i>Lower growth expectations 2004 -07</i>	-3.5	-4	-3¾	-3	-2½	-2½
• <i>Higher growth expectations 2004 -07</i>	-3.5	-4	-3¼	-2	-1	-½

Source: Updated stability programme 2003.

The budgetary planning of the different levels of government in Germany is coordinated in the *Finanzplanungsrat* on the basis of the government macroeconomic projection. Given the principle of prudence in budgetary planning, it might be worthwhile considering that the budgetary authorities coordinate on a ‘line of caution’ in their

¹⁵ European Commission: “Public Finances in EMU 2002”, European Economy 3/2002 (see Part II).

planning.¹⁶

3.7 Government debt ratio

The German debt to GDP ratio, which stood at 40% of GDP in 1991, rose rapidly as a result of reunification to exceed the reference level of 60% in 1997, dipping slightly below that only in 2001. It increased in 2003 by 3 percentage points to a level of 64%. The Stability Programme foresees a further increase in the debt ratio to 65% of GDP in 2004. The debt ratio is projected to peak at a level of 65½ % of GDP in 2005 and 2006. For 2007 it should be falling very mildly. The programme therefore foresees no improvement in the debt ratio over the whole programme period, a result that is unlikely to change even if larger privatisation programmes were launched as announced following the mediation committee negotiations. The main reason is that the primary surplus will remain negative until 2004 and only from 2005 onwards will turn mildly positive. Important also, nominal GDP growth, which at a rate of 3½ % annually remains well below that of most other EU countries, only contributes 2¼ percentage points towards the reduction of the debt-to-GDP ratio.

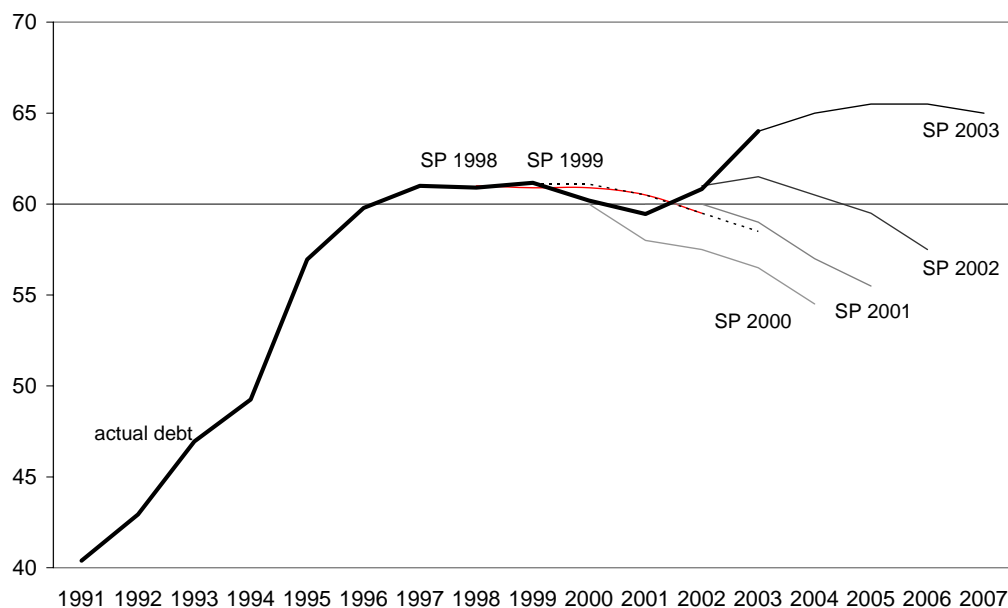
Table 6:								
Decomposition of changes in the government debt ratio								
	Mean 1997- 2002	2003		2004		2005	2006	2007
		COM 2003	SP 2003	COM 2003	SP 2003	SP 2003	SP 2003	SP 2003
Level of government debt ratio		63.8	64	65.0	65	65½	65½	65
Change in government debt ratio	-0.2	3.0	3	1.2	1	½	±0	½
<i>of which contributions from:</i>								
1. Primary balance	-1.5	1.1	0.9	0.7	0.3	-0.5	-1.0	-1.5
2. Interest expenditure	3.4	3.1	3.1	3.2	3.0	3.0	3.0	3.0
3. Real GDP growth	-0.9	0.0	0.1	-1.0	-1.1	-1.5	-1.5	-1.5
4. GDP deflator growth	-0.5	-0.7	-0.6	-0.8	-0.5	-0.7	-0.7	-0.7
5. Stock-flow adjustment	-0.7	-0.5	-0.3	-0.8	-0.7	0.1	0.1	0.1
Note: The decomposition of changes in the gross debt ratio is based on the following equation for the budget constraint: $\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \frac{D_{t-1}}{Y_{t-1}} * \frac{i - y_t}{1 + y_t} + \frac{SF_t}{Y_t}$ With: D _t = government debt; PD _t = primary deficit; Y _t = GDP at current prices; y _t = nominal GDP growth rate; i = average cost of debt; SF _t = stock-flow adjustment.								

Note: Calculations based on figures provided in the update were performed with given rounded data and are unavoidably imprecise.

Source: Commission services and updated stability programme 2003.

¹⁶ This practice is, for example, followed by the UK, where for the purpose of budgetary planning ¼ percentage point is taken off the government's central projection.

Figure 4: Public debt as % of GDP as foreseen in the stability programmes



Source: Eurostat and updated stability programmes.

Even abstracting from current deficit issues, the figures show clearly the need to embark on a budget consolidation path as early as possible, because the effect of the budgetary imbalances compounds over the years. Indeed, within a single year (between the last and the present update) the projections for the 2006 debt ratio have been revised upwards by 7% of GDP.

4. QUALITY OF PUBLIC FINANCES

The three-year economic stagnation from 2001 to 2003 was the main factor in explaining the substantial deterioration of public finances in these years. As Germany is moving out of stagnation, the country's difficulty of generating endogenous economic growth becomes more visible. It has been pointed out in previous assessments of the German stability programmes and in the Broad Economic Policy Guidelines that policies to lift potential growth are a crucial complement to a budget consolidation programme in the medium run. In this respect, Germany has made significant progress, centred on the Agenda 2010.

Most notably, a reform of the social security systems has begun. In the labour market, the so-called Hartz-reforms increase incentives to take up work, tighten eligibility criteria for unemployment aid, shorten the duration of unemployment benefit, and increase the efficiency of the labour agency. Some feeble signs are now showing that these measures are beginning to have an impact. The effectiveness of these reforms should be enhanced by the just-decided reform in job protection for small companies and the (albeit timidly) reduced regulations for market entry of crafts businesses. It is too early to judge the quantitative impact of these measures, which will only be seen over time and when the economy is starting to pick up.

The recent reforms of the pension and health care systems, while not leading to a

significant reduction in the contribution rates, will in any case scale back the increase in the fiscal burden that would have occurred otherwise. In both systems the pay-outs will be reduced. In the case of pensions this is through the introduction of a sustainability factor that limits the annual increase in pensions, while the government encourages at the same time the gradual build up of a privately funded complementary pension system. In the case of health care, patients will have to pay a higher share of the direct costs themselves, and items such as dental care and sickness benefit will be separated from the public system. This will lead to lower income-based contribution rates to the health care sector, though not necessarily to lower overall health care costs. By retrenching health care and pensions contribution rates, these measures should strengthen somewhat the economic incentive for taking up work.

The reforms of the German government are consistent with the planned reduction in the government expenditure ratio. However a reduction in government size by some 4½ percentage points of GDP over the course of four years is only credible if the country embarks on a continuous and increasingly radical reform of the welfare system. This holds similarly for the tax system where, despite broad agreement that it is too complex, the necessary cross-party consensus for reform is still lacking. Recently, however, the government announced that a proposal for a systematic reform of the tax code, without compromising budgetary consolidation, will be forthcoming.

A crucial aspect of German public finances since unification is that the effective transfers from the West to the East roughly amount to 4% of German GDP. These transfers are largely related to the fact that since the mid-1990s eastern, per capita GDP remains stubbornly at sixty percent of the western level. Despite some modest reforms at raising the efficiency of transfers, such as the Solidarpakt II, the Stability Programme contains no direct reference to a strategy on reviving the catching-up process of the East, which would be central to improving the fiscal outlook for Germany as a whole. That said, the additional flexibility that the Agenda 2010 provides notably in the labour market should make the catching-up process easier, since the existing rigidities are more binding in the East without established economic structures than in the West for which the regulations were originally designed.

5. SUSTAINABILITY OF PUBLIC FINANCES

The assessment of the sustainability of German public finances is based on both quantitative and qualitative indicators. The quantitative indicators are run on the basis of a commonly agreed methodology by the Economic Policy Committee¹⁷. The purpose of the indicators is to signal possible imbalances on the basis of current policies and projected age-related expenditure trends up to 2050. However, the limitations of this exercise are clear and results of these quantitative indicators need to be interpreted with caution. Being a mechanical, partial equilibrium analysis, projections are in some cases bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels is not a forecast of likely outcomes and should not be taken at face value. Instead, the indicators are a tool to facilitate policy debate and at best provide an indication of the timing and scale of emerging budgetary challenges that could occur

¹⁷ See the Report “The impact of ageing populations on public finances: overview of analysis carried out at EU level and proposals for a future work programme” (October 2003), available at http://europa.eu.int/comm/economy_finance/epc/documents/2003/pensionmaster_en.pdf

under a “no policy change” assumption. The quantitative indicators project debt and budget balance development according to two different scenarios, to take into account uncertainties over the medium term. The “Programme scenario” is calculated on the following basis:

- Macroeconomic assumptions on GDP growth from 2008 onwards, interest rates and inflation are based on the agreed assumptions used in the EPC;
- The projections for age-related expenditures come from the 2003 updated stability programme. These include old-age pensions, health care, education and unemployment benefits. While pension expenditure projections rely on calculations run by the Federal Ministry of Health and Social Security, other age-related spending projections come from the Economic Policy Committee harmonised exercise.
- The projections for government revenues come from the programme. They are kept constant at the (cyclically adjusted) level in 2007 except for the changes foreseen in the programme as resulting from the 2001 pension reform¹⁸. This increase (around 2 pp. of GDP between 2010 and 2050) has been fully taken into account by the Commission.
- The starting points for gross debt and the primary balance are the 2007 levels reported in the programme.

A “2003 position scenario” serves as a benchmark. It is based on the budgetary data for 2003 in the programme. Debt levels are extrapolated from 2008 to 2050 assuming that no budgetary consolidation is achieved, i.e. the cyclically adjusted primary balance in 2008 remains the same as the 2003 level and no stock-flows operations take place.

The Table below presents the debt and the budget balance development according to the two different scenarios. Overall, age-related expenditure is foreseen to increase by 5.0% of GDP between 2008 and 2050. Increases are mainly concentrated in pension expenditures (+43.9% of GDP between 2008 and 2050) despite the fact that they already include the impact of the 2001 pension reform.

Assuming no budgetary consolidation, i.e. extrapolating the budgetary status quo into the future while taking into account the ageing effects on the budget, would yield an explosive debt to GDP ratio. The same calculations based on the data of the programme update result in a ratio far above the 60% reference value. Consequently, although the announced consolidation measures are suited to relieve the strain on public finances in the long run, there is still a substantial risk of Germany’s long term public finances not being sustainable¹⁹. The budgetary strategy outlined in the programme does not lead to a

¹⁸ The German stability programme presents two different scenarios for revenues. The scenario (a) in table 10 includes the impact of the 2001 pension reform. This has been used for the quantitative indicators on long term sustainability of public finances. However, these projections do not include recent legislative changes that would imply a more favourable scenario. The scenario (b) in table 10 of the updated programme is instead a projection of revenues on the basis of foreseen and not already implemented legislation changes.

¹⁹ One additional issues warrant attention when drawing conclusions from the German assessment. As agreed by the EPC, an identical nominal interest rate is applied to all countries. The interest rate is defined as the sum of the inflation target of the ECB (2%), the projected real growth rate of the EU plus the differential of 2 between the nominal interest rate and nominal GDP growth. This leads to

sufficient reduction of the debt to GDP ratio before the demographic change fully impacts. Once pension expenditure starts to rise, the partial increase in revenues foreseen as a result of the 2001 pension reform seems not sufficient to avoid an explosive path of the debt to GDP ratio. A sustainability gap then arises. It would be even higher if Germany fails to reach its budgetary medium term target during the programme period.

Table 7: Scenarios of sustainability

Main assumptions - baseline scenario (as % GDP)	2008	2010	2020	2030	2040	2050	changes
Total age-related spending	23,2	23,3	24,5	26,7	27,7	28,2	5,0
Pensions	11,0	11,1	12,1	13,8	14,4	14,9	3,9
Health care ¹	5,9	6,0	6,4	6,7	7,0	7,1	1,2
Education ¹	5,3	5,3	5,2	5,5	5,5	5,5	0,2
Unemployment benefits ¹	0,9	0,9	0,8	0,7	0,8	0,7	-0,2
Total primary non age-related spending*	18,3						
Total revenues	43,4	43,2	43,4	44,0	44,4	44,3	0,9

¹ based on the EPC projections

* constant

Results (as % GDP)	2008	2010	2020	2030	2040	2050	changes
<i>Programme scenario</i>							
Debt	63,7	62,2	66,6	86,5	123,4	175,7	112,0
Net borrowing	-1,2	-1,5	-2,8	-5,5	-8,1	-11,5	-10,3
<i>2003 scenario</i>							
Debt	71,5	74,3	104,2	156,5	234,0	336,6	265,1
Net borrowing	-3,5	-4,0	-6,7	-11,1	-15,9	-22,0	-18,6

Sustainability gap	S1*	S2**
Programme scenario	2,2	2,6
2003 situation scenario	4,4	4,4

* S1 measures the difference between the current tax ratio and the tax ratio that would ensure a debt level in 2050 as resulting from a balance budget position over the projection period. A positive sustainability gap indicates that there is a financing gap to reach this debt level in 2050. P.m. debt to GDP ratio at the end of the period: 16.7%

** S2 indicates the change needed in tax revenues as a share of GDP that guarantees the respect of the intertemporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon.

Source: 2003 updated programme and Commission services.

As underlined in the EPC report on “The impact of ageing populations on public finances: overview of analysis carried out at EU level and proposals for a future work programme”²⁰ (October 2003), several qualitative factors should be taken on board to avoid a mechanistic interpretation of the quantitative indicators. On the positive side, there is an increasing attention to long-term sustainability of public finances and for the first time this year the Federal Ministry of Finance will submit a report on sustainability. Also, the draft laws on further pension reforms go into the direction of ensuring a more sustainable path in the future for the pension system. However, as pointed out in section

assume a nominal interest rate close to 5.5%. To avoid a discrete jump in the debt projections, it is assumed that the implicit interest rate on debt in the final year of the stability/convergence programme converges towards the common nominal interest rate over 10 years in a linear fashion. For Germany, this lead to a higher nominal interest rate than the one that would result using their projected GDP growth. The debt development would then be slightly more favourable.

²⁰ Available at http://europa.eu.int/comm/economy_finance/epc/documents/2003/pensionmaster_en.pdf

3.7, the outstanding deficit and debt levels raise concern. Public debt in particular has been on an increasing path since the beginning of nineties and has reached now levels that are above the reference value of the Maastricht Treaty.

Overall, the Commission considers that, on the basis of the current policies, risks of long term unbalances cannot be ruled out for Germany. The budgetary strategy outlined in the programme is only partially compatible with improving the sustainability of public finances. The strategy is based on a slight fiscal consolidation that would maintain the debt to GDP ratio constant over the programme period and the implementation of several structural reforms in the fields of the labour market, pension and health care.

Without a relevant impact of the announced structural reforms on the budgetary position over the next years, there is a risk that the debt to GDP ratio will not decrease enough before the impact of ageing takes place. Thus, a strict monitoring of the implementation of the reforms and their effects on the long term is envisaged to avoid Germany stepping into an unsustainable path.

ANNEX 1: Summary tables derived from the 2003 updated stability programme

TABLE 1 GROWTH AND ASSOCIATED FACTORS

% of GDP	2002	2003	2004	2005	2006	2007
GDP <i>growth</i> at <i>constant</i> market prices (7+8+9)	0.2	-0.1	1.7	2¼	2¼	2¼
GDP <i>growth</i> at <i>current</i> market prices	1.8	0.9	2.5	3½	3½	3½
GDP deflator	1,6	1.0	0.8	1	1	1
HICP change	--	--	--	--	--	--
Employment growth	-0,6	-1.0	- 0.1	¾	¾	¾
Labour productivity growth	0,8	0.9	1.8	--	--	--
Sources of growth: percentage changes at constant prices						
1. Private consumption expenditure	-1	-0.2	1.2	2	2	2
2. Government consumption expenditure	1.7	0.7	-0.2	½	½	½
3. Gross fixed capital formation	- 6.7	-3.3	1.5	2¾	2¾	2¾
4. Changes in inventories and net acquisition of valuables as a % of GDP	- 0,1	1.4	6.1	0	0	0
5. Exports of goods and services	3.4	1.1	5.8	5 ½	5 ½	5 ½
6. Imports of goods and services	-1,7	2.0	5.0	5¼	5¼	5¼
Contribution to GDP growth						
7. Final domestic demand (1+2+3)	-1.7	0.1	1.2	1½	1½	1½
8. Change in inventories and net acquisition of valuables (=4)	0,1	0.7	0.2	1½	1½	1½
9. External balance of goods and services (5-6)	1,7	-0.2	0.5	1¼	1¼	1¼

Basic assumptions						
	2002	2003	2004	2005	2006	2007
Short-term interest rate (annual average)	--	--	--	--	--	--
Long-term interest rate (annual average)	--	--	--	--	--	--
USD/€exchange rate (annual average)	--	1.12	1.15	--	--	--
(for non-euro countries) exchange rate vis-à-vis the €(annual average)	--	--	--	--	--	--
World (excluding EU) GDP growth	3%	3¼%	4%	--	--	--
EU-15 GDP growth	--	--	--	--	--	--
Growth of relevant foreign markets	--	--	--	--	--	--
World import volumes, excluding EU	3%	3%	5½%	5-6%	5-6%	5-6%
Oil prices	--	--	< \$28	< \$28	< \$28	< \$28

TABLE 2 GENERAL GOVERNMENT BUDGETARY DEVELOPMENTS

% of GDP	2002	2003	2004	2005	2006	2007
Net lending by sub-sectors						
1. General government	-3.5	-4	-3 ¼	-2 ½	-2	-1½
2. Central government	-1.6	-1.9	-1 ¾	-1	-1	-1
3. State government	-1.5	-1.5	-1 ½	-1 ½	-1	-¾
4. Local government	-0.1	-0.3				
5. Social security funds	-0,3	-0,3	-0	+0	¼	½
General government						
6. Total receipts	45.0	45.0	44 ½	44	43 ½	43
7. Total expenditures	48.5	49.0	48	46 ½	45 ½	44 ½
8. Budget balance	-3.5	-4.0	-3 ¼	-2 ½	-2	-1 ½
9. Net interest payments	3.1	3.1	3	3	3	3
10. Primary balance	-0,4	-0.9	- ¼	½	1	1 ½
Components of revenues						
11. Taxes	22.6	22.6	22½	22 ½	22 ½	22 ½
12. Social contributions	18.4	18.6	18 ½	18	17 ½	17 ½
13. Interest income	--	--	--	--	--	--
14. Other	3.9	3.8	3 ½	3 ½	3 ½	3
15. Total receipts	45.0	45	44 ½	44	43 ½	43
Components of expenditures						
16. Collective consumption		--	--	--	--	--
17. Social transfers in kind	19.7	19.8	19	19	18 ½	18
18. Social transfers other than in kind	19.4	19.7	19	18 ½	18	17½
19. Interest payments	3.1	3.1	3	3	3	3
20. Subsidies	1.5	1.4	1 ½	1 ½	1	1
21. Gross fixed capital formation	1.6	1.5	1 ½	1 ½	1 ½	1 ½
22. Other	3.2	3.5	3 ½	3 ½	3	3
23. Total expenditures	48,5	49	48	46 ½	45 ½	44 ½

TABLE 3**GENERAL GOVERNMENT DEBT DEVELOPMENTS**

% of GDP	2002	2003	2004	2005	2006	2007
Gross debt level	60.8	64	65	65½	65 ½	65
Change in gross debt		-3	-1¼	-½	½	¾
Contributions to change in gross debt						
Primary balance	-0.4	-0.9	- ¼	½	1	1 ½
Interest payments	3.1	3.1	3	3	3	3
Nominal GDP growth	1.8	0.9	2 ½	3 ½	3 ½	3 ½
<i>Other factors influencing the debt ratio</i>						
<i>Of which: Privatisation receipts</i>	--	--	--	--	--	--
<i>p.m. implicit interest rate on debt</i>	--	--	--	--	--	--

TABLE 4**CYCLICAL DEVELOPMENTS***

% of GDP	2002	2003	2004	2005	2006	2007
1. GDP growth at constant prices	0.2	0	1.7	2.2	2.2	2.2
2. Actual balance	-3.5	-4.0	-3.25	-2.5	-2	-1.5
3. Interest payments	3.1	3.1	3	3	3	3
4. Potential GDP growth	1.4	1.4	1.5	1.5	1.6	1.7
5. Output gap	-0.4	-1.8	-1.6	-0.9	-0.4	0.2
6. Cyclical budgetary component	-0.2	-0.9	-0.8	-0.5	-0.2	0.1
7. Cyclically-adjusted balance (2-6)	-3.3	-3.2	-2.5	-2.2	-1.6	-1.4
8. Cyclically-adjusted primary balance (7-3)	-6.4	-6.3	-5.5	-5.2	-4.6	-4.4

*Commission calculation. Output gap based on SGP data.

TABLE 5**DIVERGENCE FROM PREVIOUS UPDATE**

% of GDP	2002	2003	2004	2005	2006	2007
GDP growth						
previous update	2	3½	3½	3½	3½	--
latest update	1.8	0.9	2½	3½	3½	3½
Difference		-2½	-1	0	0	--
Actual budget balance						
previous update	-3¾	-2¾	-1½	-1	0	--
latest update	-3.5	-4.0	-3¼	-2½	-2	-1½
Difference		-1¼	-1¾	-1½	-2	-
Gross debt levels						
previous update	61	61½	60½	59½	57½	-
latest update	60.8	64	65	65½	65½	65
Difference		3½	4½	6	8	-

TABLE 6**LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES**

% of GDP	2000	2010	2020	2030	2040	2050
Total expenditure	--	--	--	--	--	--
Old age pensions	10.8	11.1	12.1	13.8	14.4	14.9
Health care (including care for the elderly)	5.7	6.0	6.4	6.7	7.0	7.1
Interest payments	--	--	--	--	--	--
Total revenues	--	--	--	--	--	--
<i>of which:</i> from pensions contributions	--	--	--	--	--	--
National pension fund assets (if any)	--	--	--	--	--	--
Assumptions						
Labour productivity growth	--	--	--	--	--	--
Real GDP growth	--	--	--	--	--	--
Participation rate males (aged 20-64)	--	--	--	--	--	--
Participation rates females (aged 20-64)	--	--	--	--	--	--
Total participation rates (aged 20-64)	--	--	--	--	--	--
Unemployment rate	--	--	--	--	--	--

TABLE 7 BASIC ASSUMPTIONS, 2003 COMMISSION AUTUMN FORECAST

		2002	2003	2004	2005
Basic assumptions					
Short-term interest rate (annual average)		3.3	2.3	2.3	3.2
Long-term interest rate (annual average)		5.0	4.1	4.4	4.8
USD/€exchange rate (annual average)		0.95	1.13	1.16	1.15
(for non-euro countries) exchange rate vis-à-vis the €(annual average)		--	--	--	--
World excluding EU,GDP growth		3.2	3.9	4.5	4.5
EU-15 GDP growth		1.1	0.8	2.0	2.4
Growth of relevant foreign markets		3.9	3.2	6.5	7.3
World import volumes, excluding EU		--	6.3	8.3	8.6
Oil prices		25.0	28.3	25.6	24.1